No. 92-466

In The

Supreme Court of the United States

October Term, 1992

LIGGETT GROUP INC., now named Brooke Group Ltd.,

Petitioner,

vs.

BROWN & WILLIAMSON TOBACCO CORPORATION,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fourth Circuit

REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

The issue before the Court is whether the Fourth Circuit correctly decided that predatory pricing is such an implausible strategy for an oligopolist that a jury verdict under the Robinson-Patman Act must be set aside. The jury necessarily found that respondent B&W had engaged in below-cost price discrimination with a reasonable prospect of recoupment -- that is, predation. *See infra* p. 9. The Fourth Circuit affirmed judgment notwithstanding the verdict on the ground that only a monopolist or conspirator can be sufficiently certain of recoupment to engage in predatory price discrimination. It did not adopt B&W's version of the facts.[1]

1. *The Fourth Circuit Ruled Out Oligopolistic Predation as a Matter of Law.* Far from being "fact-bound," the opinion below proclaims its generally applicable "economic logic." The court recognized that the verdict "amounts to substituting the conscious parallelism of an oligopoly for conspiratorial agreement or actual monopoly power as the reason Brown & Williamson might rationally expect to be able to recoup its investment in disciplining Liggett." Pet.

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*Reference is made to Pet. Br. 2 at n.2 for Liggett's statement pursuant to Supreme Court Rule 29.1.

[1]In particular, the Fourth Circuit did not deny that a reasonable jury could find that B&W itself concluded that it could recoup an investment in below-cost pricing, that B&W actually priced generic cigarettes below their average variable cost under a plan to injure *consumers* as well as Liggett, that regular-brand prices were supracompetitive, and that cigarette prices rose more than costs or inflation. *See infra* pp. 11-19 (setting the record straight in response to the extravagant factual claims of B&W's brief). As for the district court, it concluded that B&W's plan was anticompetitive and designed to "slow the growth of the generic cigarette segment." Pet. App. at 31a. The district court made clear, moreover, that apart from its view of the law, it regarded the verdict as fully supported. *Id.* at 19a n.6. In any event, the facts must be viewed in the light most supportive of the verdict. *See infra* p. 11.

App. at 11a. The court then proclaimed that oligopolists cannot be "certain" (*id.* at 11a) or "assured" (*id.* at 14a) of one another's reactions, and ruled: "To rely on the characteristics of an oligopoly to assure recoupment of losses from a predatory pricing scheme after one oligopolist has made a competitive move is thus economically irrational." *Id.* at 13a. To be sure, the Fourth Circuit mentioned the "actual experience in this case," but only to use growth in the generic sector to buttress -- erroneously (*see infra* pp. 6-7) -- its "theoretical suspicions." Pet. App. at 12a.

B&W itself underscores the theoretical rather than factual basis of the Fourth Circuit opinion by defending it with arguments that immunize every oligopolist on theoretical grounds no matter how far below average variable cost its price discrimination, how high the profits it seeks to protect, or how explicit its anti-consumer strategy.[2] Indeed, the only *fact* cited by B&W to show the "impossibility" of Liggett's claim is B&W's 12% market share (Resp. Br. at 40), which is only another way of saying that B&W is not a single-firm monopolist capturing the entire benefits of predation as its recoupment. But recoupment does not require that a predator obtain all the benefits of predation, only enough of them to exceed substantially its investment in predation. *See* Pet. Br. at 28-29. B&W calculated that it alone could lose $350 million if generics continued to grow at the same *rate*. To recoup its investment of $15 million in below average variable cost pricing, B&W would have to slow the growth rate by only a small amount -- which its sophisticated managers decided they could achieve. If prospective recoupment is ruled insufficiently plausible here, no

[2]B&W was more explicit below, asking the Fourth Circuit to rule out oligopolistic predation as a matter of law on the ground that "[r]ecoupment requires the acquisition and sustained exercise of monopoly power" and that monopoly power requires a "single firm" with at least a "dominant share" of the market. B&W's Fourth Circuit brief at 21, 24-25. Amici supporting B&W are equally explicit, asking this Court to adopt the Sherman Act standard and require a dangerous probability of single-firm monopoly before allowing any violation of the Robinson-Patman Act to be found.

oligopolist can ever be liable for unjustified below-cost price discrimination.

B&W's theoretical arguments, relying largely on "game theory," also rest on the false premise that coordinating oligopolists need to coordinate everything in order to achieve or maintain supracompetitive prices. B&W insists that tacit price coordination in an oligopoly "requires a single variable, usually price." That is quite wrong, for tacit price coordination can, and often does, exist side by side with non-price rivalry in such multiple variables as advertising and product variations.[3]

B&W insists that it "was not even a theoretical possibility that B&W could plan a predatory campaign on the basis of confidence about the reactions of others" because (1) a predating oligopolist must have "assurance that no other cigarette seller will enter, expand, or maintain low prices in the generic segment," and (2) such assurance is impossible "without communication" when the situation is new, variables are numerous, and when views differ on whether it will be profitable to enter generics and in what form. Resp. Br. at 36-38. But this ignores B&W's own express calculation that fellow oligopolists (a) were likely to enter the generic segment with variations in packaging, promotions, and marketing, (b) had the strongest possible incentive to narrow the discount as far as possible in order to minimize cannibalization of their mainstay regular brands, (c) would move branded-generic prices up quite readily after such brands won consumer loyalty, and (d) would continue to price branded cigarettes in the textbook oligopoly fashion of preceding decades -- even without any overt communication.

[3]Indeed, this point is made by the very authority B&W cites for the proposition that numerous variables complicate oligopolistic coordination and that the cigarette manufacturers have recently "failed to achieve a high degree of market-sharing coordination." Resp. Br. at 38 n.30. The precise point of Scherer & Ross, *Industrial Market Structure and Economic Performance* 251 (3d ed. 1990), is that non-price rivalry can affect market shares without preventing oligopolistic price leadership and an increase in profits "from $3.80 to $11.55 per thousand cigarettes sold between 1980 and 1988."

See Pet. Br. at 17-18. Indeed, B&W studied past episodes of disciplining price cutters before embarking on its below-cost price discrimination. PX 40, Tr. 60:62, J.A. 128. Not only was it "a theoretical possibility that B&W could plan a predatory campaign," it did so.

B&W theorizes that one firm cannot discipline a maverick "without unraveling . . .[o]ligopoly cohesion," asking "[i]f Liggett is permitted to assume a divergent strategy by B&W, why must B&W be assumed to predict *uniform* reactions by all four other firms," and asserting that "[d]isciplinary measures recognized in contemporary theory always involve participation by *every* rival." Resp. Br. at 39 (original emphasis). Again, the facts are otherwise. B&W itself explained that it would discipline Liggett unilaterally because its larger rivals, though they would welcome a narrower gap, (1) would not discipline Liggett because of the greater risk of being held accountable for violating the antitrust laws and (2) would not need to do so once B&W acted. *See* Pet. Br. at 17. B&W could discipline Liggett without the participation of the larger oligopolists because only B&W and Liggett were selling black-and-white cigarettes at the time. Significantly, Doral did not participate in the rebate war. Pet. Br. at 8 n. 12.

In disowning the oligopoly recoupment strategy carefully worked out and analyzed by B&W's sophisticated senior officers, B&W's brief, like the Fourth Circuit, draws absolute rules from an economic theory that is only suggestive in the first place, theorizing about markets in the abstract rather than attending to the facts of this case. Short of establishing genuine impossibility, B&W's arguments about the complexities and uncertainties of recoupment in oligopoly cannot immunize unjustified below-average-variable-cost pricing designed to injure consumers, for the law requires only a "reasonable possibility." Apart from its theoretical arguments, B&W offers no valid reasons why the jury verdict should not stand. *See infra* pp. 9-19.

2. *The Robinson-Patman Act Reaches this Case.* B&W argues that the Robinson-Patman Act covers, at most, only geographic discrimination and perhaps "non-geographic cases where the predator operates in many product markets and the victim in but one."[4] Resp. Br. at 42. B&W's rationale for its limitation is that a multi-product predator can outlast the one-product victim, but that outlasting rationale condemns B&W's below-cost discrimination based on its own explicit analysis that Liggett was dependent upon black and whites rather than regular brands (J.A. 73), would be "unlikely . . . to engage in a sustained battle" (J.A. 97), and "will try to survive" the losses inflicted by B&W by "raising [list] prices on generics." J.A. 253. *See also* J.A. 260, 263.

Although B&W insists that "Liggett's case . . . goes far beyond any decided [Robinson-Patman Act] case" (Resp. Br. at 41), its conduct was clearly less justifiable than that held unlawful by the Court in *Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967), and the threat to competition here was clearly greater than in that case.[5] Far from asking this

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[4]In B&W's non-geographic illustration, competition is injured because the predator earns profits on products other than the one that is sold at discriminatory prices -- not because the higher of the discriminatory prices subsidizes the lower one. B&W thus retreats from its contention that the difference between the high and low prices must "cause" the competitive injury -- a causation that B&W has denied when both the high and low prices are below cost. The most that price discrimination can do in any case is to facilitate predatory pricing by reducing its cost and therefore its risk. *See* Pet. Br. at 21 n.23, 27. B&W concedes as much. Resp. Br. at 29 n.24. Its counterargument that such discrimination made it cheaper for Liggett to resist is erroneous, for Ligget had to offer similar rebates over a then-larger volume of generics. In any event, the next text point is a dispositive answer.

[5]There, modest evidence of intent to harm a rival by planting a spy in its plant and referring to it as an "unfavorable factor in the market"; here, overwhelming evidence of unambiguous intent to harm both a rival and consumers, an express and sophisticated analysis of how to succeed in doing so, and a declaration of actual success. There, prices below some measure of cost for short periods; here, non-introductory, non-promotional prices below average variable cost for at least eighteen months. There, no entry barriers or persistent oligopoly with

Court to broaden the scope of liability in *Utah Pie*, Liggett asks this Court to reverse the Fourth Circuit on the basis of a rule far more demanding than that implicit in *Utah Pie*.

3. *Actual Effects*. Although both parties agree that the generic sector has expanded, B&W does not deny that all cigarette prices rose faster than costs or inflation -- 58% for generics and 32% for regular brands between December 1985 and December 1988. J.A. 325. But the generic sector did not expand *because of* B&W's below-cost pricing but in spite of it. B&W's conduct resulted in higher prices,[6] which cannot increase demand and always constitute injury to consumers.

Slowing the growth rate of generics allowed B&W to recoup by protecting some supracompetitive, regular-brand profits from greater cannibalization than would otherwise have occurred. According to its own plans, B&W's objective was satisfied by slowing the growth *rate* for generics, a result

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supracompetitive prices or other source of recoupment anticipated by defendants or otherwise; here, some $350 million of recoupment sources by defendant's own calculation. There, no evidence that consumers ultimately paid higher prices; here, the relative price of the generic product rose and all prices rose more than costs or inflation. J.A. 747-49, 509-11, 514-26. Moreover *Utah Pie* cannot be limited to geographical discrimination. *See* Pet. Br. at 35; Liggett reply to B&W opposition to certiorari at 5.

[6]*See Standard Oil Co. of California v. United States*, 337 U.S. 293, 314 (1949) (Frankfurter, J.) (even if flourishing, competition might have been more vigorous in the absence of the challenged restraint). *See also Zoslaw v. MCA Distributing Corp.*, 594 F.Supp. 1022, 1033 (N.D. Cal. 1984). B&W seeks to bolster its rendition with material concerning matters occurring since the trial and even since the judgment. Such material was not, and could not be, in the record. This is a patent breach of appellate procedure that cannot be obscured by B&W claims that its incomplete rendition of non-record material is reliable. Resp. Br. at 16 n.10. Although it would be inappropriate to argue the point here, the non-record material actually shows consumer injury. *See* Liggett reply to B&W opposition to certiorari at 9 n.17.

that it admitted achieving.[7] *See* Pet. Br. at 19. As the district court itself recognized during trial, "The slowing of the growth of the category gives recoupment in the branded sales retained, and a slowing of the growth of the segment can lessen the downward pull on the branded prices." Tr. 67:63.

In any event, an expectation of recoupment -- by the defendant at the time of below-cost pricing or by a court viewing the world as of that time -- can be eminently reasonable even if it turns out to be wrong. *See* Pet. Br. at 45-46. Contrary to B&W's assertion (Resp. Br. at 48), Liggett would not forbid looking at what actually happened in the marketplace to help interpret ambiguous conduct. But once conduct is sufficiently dangerous to be held illegal at the time it occurs, post-predation developments cannot erase the violation. The plain words of the statute condemn conduct that "may tend substantially to lessen competition" or, as the Court says, has the reasonable possibility of injuring competition. B&W asserts that the Fourth Circuit applied the "reasonable possibility test" but is unable to show where because that court never even stated, much less applied, that test.

B&W cites not a single case holding that subsequent events make conclusively lawful what would otherwise have been unlawful predation at the time it occurred.[8] Nor does

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[7]B&W now acknowledges that "*every* sale of a discounted cigarette puts a 'brake' on market prices by reducing demand for full-price brands." Resp. Br. at 16 n.11 (emphasis original). B&W thus recognizes that it recouped losses when Liggett increased its generic prices in June 1985 and thereafter, because a larger discount would have been a stronger brake. Indeed, B&W executives thought precisely in terms of "brak[ing] the growth of the generic segment." Tr. 61:233.

[8]*Boise Cascade Corp. v. FTC*, 837 F.2d 1127, 1144 (D.C. Cir. 1988), held only that the *automatic* inference of *secondary-line* injury to competition (among customers of a discriminating seller) that is drawn from the mere existence of price discrimination may be rebutted by actual evidence. As for *O. Hommel Co. v. Ferro Corp.*, 659 F.2d 340, 347 (3d Cir. 1981), *cert. denied*, 455 U.S. 1017 (1982), it was a case in which "[e]ven the most generous reading of the full record fails to disclose

B&W offer any reason for giving subsequent events that force. Despite B&W's dismissal of the law's educational function (Resp. Br. at 47-48), the law often seeks to deter dangerous conduct even if the danger does not materialize in a particular case.

4. *Policy.* It would indeed be bad policy to condemn aggressive price competition on the basis of an expressed intent to take business away from a rival. *See* Pet. Br. at 36-37. Such an intent is not anticompetitive. Moreover, the courts should not test the rough-and-tumble language of business people as if uttered by philosophers. It would also be bad policy "[i]f concentration is enough to put a 12% firm in danger for price cutting...." Resp. Br. at 32. But Liggett does not contend that concentration is enough, though B&W's economic expert conceded that industries as concentrated as the cigarette industry are very uncommon. J.A. 743-45.

Liggett's claim rests on unjustified discriminatory prices below average variable cost that create a genuine danger (which defendant expressly analyzed and concluded was likely) of disciplining a maverick discounter, increasing consumer prices, and protecting supracompetitive regular-brand profits. Moreover, Liggett's claim passed through powerful filters designed to protect price competition. *See* Pet. Br. at 42. The average-variable cost filter alone has proved a formidable and objective obstacle to excessive claims.[9] Liggett respectfully submits that the Fourth Circuit

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competitive harm," so that it would be purely "speculative" to assert that there might have been more competition. Here, the Fourth Circuit itself noted that the price discount had lessened, which necessarily reflects lessened competition.

[9]B&W's expert economist agreed that the average variable cost test is "a tough test for plaintiffs to meet." Tr.101:184. Amicus ITT urges the Court to rule that a price is not predatory when marginal revenue (not price) exceeds marginal costs. ITT br. at 9. Such a price is short-run profit maximizing and therefore not predatory. *See* P. Areeda & D. Turner, *3 Antitrust Law* ¶715a (1978). It may therefore be useful as a defense in some circumstances. However, condemning as predatory all prices that are not short-run profit maximizing would increase, not reduce, liability. *See id.* at ¶713 and P. Areeda & H. Hovenkamp,

can be affirmed only if the Court concludes that (1) such filters are inadequate *and* (2) it is appropriate for the Court to immunize conduct that precisely fits the statutory words "may tend substantially to lessen competition."

5. *Jury Findings.* The jury answered "yes" to the specific question whether B&W "engage[d] in price discrimination that had a reasonable possibility of injuring competition in the cigarette market as a whole in the Unite d States." J.A. 27. Instruction No. 12 defined "injury to competition" with reference to "loss-creating price cutting" and "recoup[ing] losses by raising and maintaining prices a t higher than competitive levels." J.A. 830. Hence, the ju ry must have found a reasonable prospect of recoupment as well as below-average-variable-cost pricing, which was the only "loss-creating price-cutting" alleged in this case, discussed at trial, or mentioned in the instructions.[10]

While Instruction No. 18 allowed the jury to infer a reasonable possibility of injury to competition from "direct" evidence of "predatory intent," the jury was told that the only intent relevant to this case is one "in which a company plans to discipline...rivals...so that it can earn higher than competitive profits...." Inst. No. 19, J.A. 835.[11] The term

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Antitrust Law, ¶714.2d (1992 Supp.), for a discussion of prices that should not be deemed predatory even though they fail to maximize short run profits. Moreover, short-run profit maximization will seldom be clear. Contrary to ITT, many of the classification problems associated with other cost tests remain.

In any event, that issue is not present here. B&W hired an expert accountant who testified at deposition that he would compare B&W's anticipated and actual marginal revenues and marginal costs. However, B&W never called the expert as a witness and objected strenuously when Liggett attempted to question B&W's expert economist about the results of that study. Tr. 101:172-79. Both parties requested instructions asking the jury to compare price with average variable cost.

[10]The district court judge correctly told counsel, "I'm not going to charge the jury. . . that they can find predation in this case, if there's above average variable cost pricing." Tr. 111:79.

[11]In addition to Instructions No. 12 and No. 19, Instruction No. 30

"discipline" meant below-average-variable-cost pricing because that was the only disciplining at issue, and both parties agreed that such pricing was an essential element of predation.[12] In any event, B&W's own expert economists admitted that, apart from claimed tax-savings, B&W's generic prices were below average variable cost. *See infra* pp. 15-17.

Furthermore, contrary to B&W's repeated suggestion, many of its factual claims were necessarily rejected by the jury, which had been specifically instructed that it could absolve B&W of liability if (1) "competition actually increased," which could trump any inference of injury to competition drawn from either below-cost pricing or direct evidence of predatory intent (Inst. No. 20, J.A. 836); (2) B&W's pricing had been "a legitimate, competitive response to market conditions" (Inst. No. 19, J.A. 835), was "introductory" (Inst. No. 27, J.A. 842), or "motivated by a good faith effort to meet competition" (Inst. No. 34, J.A. 847); or (3) B&W "reasonably believed that its average

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also contradicts B&W's repeated assertion that the jury could have based liability solely on "aggressive" language in B&W's documents: It specifically warned the jurors that "business people often use aggressive words to describe lawful competitive activities." J.A. 843-44. In any event, B&W documents analyzed in cool and calculated prose how below-cost pricing would cause Liggett to raise consumer prices for generics, thereby protecting regular-brand profits. Finally, the district judge's supplemental instruction did not "invite" a verdict based on bad intent alone. Resp. Br. at 9. That instruction stressed the need to read all the instructions as a whole. Tr. 123:27-30.

[12]For example, Liggett's closing argument was couched in those terms: "B&W's scheme was predatory. It intended to price its generic cigarettes below average variable cost in order to make Liggett bathe in red ink." Tr. 113:117. Moreover, under Instruction No. 16, J.A. 833, a finding of predatory intent was but one step in the process of inferring reasonable possibility of injury to competition, as defined by Instruction No. 12, J.A. 830. B&W complains that "the sole example of conduct given [in Instruction No. 29] was the alleged copying of Liggett's packaging" (Resp. Br. at 7), but the jury expressly found no infringement (J.A. 28) and therefore could not have based a finding of predatory intent on the alleged copying.

variable cost would not exceed its net prices" (Inst. No. 26, J. A. 841).[13]

6. *Keeping the Record Straight.*[14] It is elementary that courts reviewing a judgment for defendant notwithstanding a jury verdict do not assess the evidence *de novo* but in the light most favorable to the non-moving party.[15] *See* J. Friedenthal, M. Kane, & A. Miller, *Civil Procedure* 546-547 (1985). Nevertheless, B&W devotes the greater portion of its brief to rearguing the "facts" that it unsuccessfully presented to the jury. Though instructed by its parent company that it should "avoid price competition whenever possible" and that price cutting moves by others "should be countered swiftly and dominantly" (PX7098A, Tr. 47:53), B&W now attempts to transform itself into a champion of price competition and to portray the industry as the paradigm of robust competition. Although that attempt

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[13]B&W's objection to the instruction requiring Liggett to prove that B&W had power in a cigarette market or generic submarket is irrelevant if this Court agrees that Robinson-Patman Act liability does not require single-firm domination of any market. The submarket instruction did not in any way lessen the required showing of a reasonable possibility of injury to competition in the cigarette market as a whole. J.A. 27.

[14]B&W seems to argue that even if a defendant's pricing is illegal and designed to weaken or discipline a rival in order to injure consumers later with higher prices, the victim lacks standing to recover its losses during the predatory period if it survives to benefit from later high prices. Resp. Br. at 45 n.34. But Liggett sought compensation only for the losses intentionally inflicted upon it by B&W's below-average-variable-cost price discrimination. Whether post-predation prices were optimal for Liggett (with its very small share of regular brands) was not litigated by either party. In any event, a rival's loss caused by the predator's below cost pricing always constitutes antitrust injury. *See Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 339 (1990) (victim of predatory pricing always suffers antitrust injury). *See* Pet. Br. at 46 n.58.

[15]Even if the instructions had allowed the jury to base liability on alternative theories, a reviewing court still assumes the non-moving party's account to be true when supported by the record, as it does at the directed verdict stage before any jury instructions or verdict. 5A J. Moore, *Moore's Federal Practice* ¶ 50.07 [2] at 50-81 (2d ed. 1992).

is not pertinent to the legal issues before this Court, B&W's extravagant factual claims cannot be left unanswered.

a. *Supracompetitive Profits.* B&W concedes that "cigarette industry profitability . . . remained high in the 1980's . . . " (Resp. Br. at 20 n.15),[16] but then argues that Liggett executives demolished the premise of supracompetitive prices and profits by denying that the cigarette industry is a "collusive oligopoly" with "tacit collusion." Resp. Br. at 19. However, such testimony cannot preclude a reasonable jury from finding supracompetitive pricing. *See* Pet. Br. at 7 n.11. *Compare* Tr. 67:62-64 *with* Resp. Br. at 19 n.14. B&W also argues that the cigarette industry is not a stable oligopoly, citing gradual changes in market share and increasing couponing and other promotional programs. Resp. Br. at 11. However, changes in market shares are consistent with supracompetitive profits (*see supra* p. 3 n.2), and the promotional payments are fully accounted for within the industry's high profits. J.A. 508-09. Moreover, expenditures on such promotional payments have been greatly exceeded by price increases. *Id.* As to the article supposedly indicating that the cigarette industry is "at least moderately competitive" (Resp. Br. at 20, 38), it concludes only that the industry is not "a perfect cartel." D. Sullivan, *Testing Hypotheses About Firm Behavior in the Cigarette Industry*, 98 J. Pol. Econ. 586, 593 (1985).

Without denying that regular-brand profits are supra-competitive, B&W asserts that "the $350 million is a pre-Doral estimate of the profit B&W would lose if it did not go into generics" (Resp. Br. at 25), suggesting that the $350 million represents potential profits *on* generic sales. That is contrary to the plain meaning of B&W's contemporaneous documents, which project losing $350 million in regular-brand revenue *to* generics through 1988:

[16]The intangible value of brand names does not explain profits exceeding those in the food and kindred products group, where valuable brand names also abound. In any event, the supracompetitive profits of the cigarette industry are inferred from far more than high accounting rates of return. *See* Pet. Br. at 5-7.

> In 1983 B&W lost about 3.7 billion sticks to generics, a variable margin loss of over $50 MM. By 1988, this could total 18 billion sticks and about $350 MM lost variable margin. J.A. 83.

The repricing of Doral did not lead B&W to lower that $350 million estimate. J.A. 138.

b. *B&W's Unwavering Plan.* Ignoring its concession in the Fourth Circuit that its plan was anticompetitive[17] and ignoring the district court's strong conclusion that B&W's anticompetitive intent was clearly documented (Pet. App. at 31a), B&W now argues that it "did not plan to injure competition." Resp. Br. at 16. B&W now claims that after R.J. Reynolds repositioned Doral, it abandoned whatever predatory intent it may have had in early 1984. In fact, B&W's post-Doral business plan expressly confirmed that B&W's "[p]lan of action to be followed is exactly as our previous proposal outlined." J.A. 121. B&W saw no reason to change its previous plan given that, as B&W concluded, black-and-whites would continue to grow and Liggett would still need to be disciplined because R.J. Reynolds -- though its objective was consistent with B&W's to manage the price of generics upward -- could not be expected to discipline Liggett. *See* Pet. Br. at 11-12,17. Significantly, B&W does not and cannot point to a single respect in which its post-Doral conduct differed from its pre-Doral plan.

B&W complains that "Liggett seizes on two phrases in a rough, handwritten note by a Ms. Tharaldson (J.A. 61), a seventh-tier (two from the bottom of the sales hierarchy) manager (PX 27; Tr. 2:198-99), that B&W could 'signal' to competition that it would not expand the generic segment and wished to 'put a lid on Liggett.'" Resp. Br. at 17. But

[17]When the court asked whether B&W "intended to monopolize, but flopped," B&W's counsel replied that if the plans and predictions set forth in B&W's documents had materialized "they [Liggett] would have a case against us for predatory pricing." Oral Argument Tr. at 33-34.

B&W's minimization of her role is incorrect,[18] and B&W cannot deny that her notes are fully consistent with B&W's strategy documented at the company's highest levels.[19]

c. *Price Discrimination Unjustified.* B&W denies neither that discrimination played an important role in its planning nor that its rebates were unprecedentedly large. Instead, B&W tries to portray Liggett as the aggressor in the so-called rebate war, ignoring its own contemporaneous documents. B&W's Final Proposal to its parent company expressly conditioned the launch of its black and white cigarettes on "[s]uperior discounts/allowances." J.A. 142. Moreover, B&W predicted that Liggett would respond to B&W's announced rebates by increasing the size of its own rebate: Liggett "can be expected to minimally match the competitive offer." J.A. 91. In every volume category except the smallest, B&W's rebate offers exceeded Liggett's, and B&W continued to increase its rebates even though Liggett *never* met B&W's rebate at any time during the so-called rebate war. J.A. 327-28. The jury explicitly found that B&W did not "engage in price discrimination in good

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[18]Ms. Tharaldson reported directly to D.P. Christensen, the Director of National Sales Development (the number three position in the sales side of B&W) (Tr. 71:158-59); was a hand picked member of the Generic Task Force formed to investigate and plan for B&W's entry into generics (Tr. 71:163); and gave deposition testimony that in developing B&W's plan to enter the generic segment, she worked directly with such high level officers within B&W as Mr. Alar (Vice Chairman of the Board), Mr. Sandefur (President), Mr. Butler (Vice President of Sales), Mr. Parrack (Vice President of new products), Mr. Heger (Senior Vice President Finance and Planning) and Mr. Bacon (Controller). (She claimed to have no knowledge of the contents of her own handwritten notes, to the expressed disbelief of the trial court judge. Tr. 35: 127-28). (Because her notes (J.A. 60) first became an exhibit at the deposition of Olges, they remained marked as "Olges 15," causing the inadvertent reference to Olges in the table of contents to the joint appendix.)

[19]B&W's "pro-forma" profit and loss statement accompanying its Final Proposal to BATUS which assumed that the generic discount would remain at 35% *confirms* B&W's anticompetitive objective of preventing a widening of the discount gap. Moreover, B&W's subsequently approved 1986-1990 corporate plan projects the discount narrowing from 38% in 1985 to 28% in 1990. J.A. 283.

faith with the intention to meet" competition with Liggett. J.A. 27-28.

B&W's repeated characterization of the rebate war as normal price competition ignores the facts that no other firm participated in the so-called war and that B&W priced well below average variable cost for 18 months. *See* Pet. Br. at 13-14, 18.

d. *Prices Below Average Variable Cost.* The admissions of B&W's two economic experts to the direct, non-hypothetical question, "Did B&W price above or below average variable cost in 1984 and 1985," are dispositive. J.A. 651, 740.

B&W argues that those admissions ignore "an important source of cost savings that B&W realized because of tax reductions due to additional sales volume and its LIFO accounting system," in the light of which "B&W clearly did make very substantial profits on its generics." Resp. Br. at 23-24. However, the argument fails legally and factually. Even if B&W's entry into generics achieved such savings, it does not argue that its entry required pricing below average variable cost. Moreover, a tax deduction cannot transform an otherwise predatory price into a lawful one. *See* Pet. Br. at 14 n.16. Furthermore, B&W cites no record evidence of such savings,[20] and its own controller testified that purchasing the leaf cost more than any tax benefits were worth. Tr. 98:187, 192, 194. Finally, B&W unsuccessfully made its tax-savings argument to the jury, which was permitted to "reject an inference of predatory intent" if tax benefits were "a substantial motivation" for B&W's entry into generics. Inst. No. 28, J.A. 842.

B&W complains that the eighteen month period at issue was "artificially" or "arbitrarily" selected by Liggett. Resp.

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[20]Its claim that Liggett's expert conceded the existence and relevance of such savings is wrong. Liggett's expert only agreed with the cross-examiner's redundancy that if tax savings exceeded losses, then losses would be less than savings. Tr. 57:135-36.

Br. at 22 n. 17, 24. In fact, those eighteen months covered the entire time from B&W's entry to the pre-trial cut-off of discovery -- a date requested by B&W over Liggett's objection. B&W Memorandum, Fourth Circuit Docket No. 316. Moreover, B&W's own expert economist characterized the eighteen month period as a "fairly long time period of analysis" for purposes of the average variable cost test. Tr. 102:67-68. Furthermore, B&W made its unreasonable-time-period argument to the jury which was told to consider it. Inst. No. 25, J.A. 840.

B&W also argues that it "made profits on black-and-whites in seven scattered months of that period, and its black-and-whites were profitable when viewed over the twenty four-month period following their introduction." Resp. Br. at 24. But B&W fails to disclose that it is not writing about "profits" in the usual sense but about what it calls "trading profit," which measures the difference between total revenue and certain (*but not all*) variable costs. *See e.g.*, Tr. 62:78. Trading profit does not take into account certain major admittedly variable costs such as the costs associated with maintaining tobacco leaf and other supplies in inventory. Tr. 101:202, Tr. 62:40. When all variable costs are counted, B&W priced below average variable cost in each of the 18 months from its first shipment of generics until the close of discovery. PX 3952 R, 3956 R, Tr. 48:27. Moreover, when B&W asserts that in the 18 month period "it fell . . . 1% short of break even" it again fails to disclose that it is not using total cost or even average variable cost as the "break even" point but an arbitrary internal accounting measure of some but not all variable costs. In fact, B&W fell approximately 20% below average variable cost for the 18 month period. J.A. 338.

Finally, B&W argues that even if it did sell at prices below average variable costs, it did not *intend* to set its prices as low as it did set them. But not even B&W claims that it set its prices by mistake for eighteen months. Moreover, a price-cost test would be meaningless if a defendant could avoid its reach merely by claiming that it lowered its prices in response to "market conditions." Once a defendant persistently prices below average variable costs, an asserted

earlier hope, later abandoned, of remaining above costs does not immunize sustained below-cost pricing.[21]

e. *Liggett Disciplined.* B&W studiously ignores its own documents predicting that it could force Liggett to raise list prices. *See* Pet. Br. at 15-16. Moreover, the district judge stated in denying B&W's motion for a directed verdict, "the ability of [Liggett] to compete and to offer consumers a lower price had been compromised. [B&W] recognized this in their own documents in evidence."[22] Tr. 67:64.

B&W's argument that Liggett "surrendered" in March 1984 before B&W entered the segment ignores the context. Liggett's March 1984 generic price increase was a delayed response to the 1983 federal excise tax increase of $4 per thousand. While all cigarette manufacturers responded by increasing list prices on regular brands by more than $4, Liggett raised its generic prices only $2 then and another $1.50 in 1984. With all price changes taken into account, the discount gap widened to 37.8% by June 1984. J.A. 325.

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[21]B&W does not fall within the qualification that permits an expanding firm that "reasonably anticipates" declining manufacturing costs, to rely on those lower anticipated costs -- rather than its higher present costs -- when it sets its prices. *See* P. Areeda & D. Turner, 3 *Antitrust Law* ¶ 715d at 175 (1978). As a matter of fact, moreover, B&W errs in asserting that its intention to remain at "full variable margin" shows a plan to price above costs. Even under the interpretation most favorable to B&W, spending "full variable margin" would mean zero "trading profit" (Resp. Br. at 22), which necessarily means pricing below cost as explained above. Thus, even if the financial schedule attached to B&W's Final Proposal showed zero "trading profits," it does *not* mean that B&W intended to remain above average variable cost. As B&W's contemporaneous documents made quite clear, B&W was "not going into it [black-and-whites] with the objective to make a profit." J.A. 174. *See also* J.A. 53; Tr. 62:36-43, 49-60, 74-79, J.A. 663-67.

[22]B&W cites a 1981 Liggett document purporting to say that Liggett wanted to close the discount gap to 24% by August 1985. Resp. Br. at 27 (citing DX 36R at AB 173157, Tr. 68:163). The reference to a 24% gap is merely an assumption of what would happen if the *dollar* amount of the discount were to remain constant while regular-brand prices predictably increased.

Further, B&W contends that Liggett's price increase in 1985 was a mere bookkeeping surrender because Liggett increased its rebates at the same time. That contention ignores B&W's own distinction (which its brief does not retract) between higher rebates that would not benefit consumers and higher list prices that would burden consumers and narrow the gap. *See* Pet. Br. at 10. To be sure, Liggett did increase its rebate by a proportionate amount to a *few* large customers in order to keep their business, but that did not prevent consumer prices from rising.

Nor is B&W correct when it asserts that "the one time B&W initiated a generic price increase, Liggett did not follow." Resp. Br. at 26. After Liggett resisted a B&W price increase in December 1985,[23] B&W increased black-and-white prices three more times before trial and Liggett followed each time.[24] J.A. 295-302, 304-307.

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[23]B&W asks, "If Liggett easily 'resisted' B&W's attempted increase at the very end of the alleged 'period of predation' [December 1985], why would it 'follow' B&W increases thereafter?" Resp. Br. at 26. December 1985 was not the end of the period of predation, but merely the cut-off of discovery, and thus Liggett was unable to establish how long after December 1985 B&W continued to price below average variable cost.

[24]B&W claims that Liggett "simply made up" the fact that it followed B&W's lead in raising prices in 1986, 1987, and 1988. Resp. Br. at 26. The record shows that on June 12, 1986, B&W signaled its intent to raise generic prices by informing all distributors that they could only purchase a limited number of cigarettes at the current price. J.A. 295. On the next day, Liggett increased its generic prices. J.A. 297. On December 4, 1987, B&W increased generic prices by $2.75. J.A. 299. On December 8, 1987, Liggett followed with a $2.50 price increase. PX 2080, Tr. 60:63, partially reprinted at J.A. 301. On June 16, 1988 B&W initiated a $2.75 increase, and on June 17 Liggett followed. J.A. 304-306.

f. *Fellow Oligopolists.* B&W continues to ignore its contemporaneous documents that anticipated its fellow oligopolists' likely entry into generics and analyzed their common interest in narrowing the discount. Instead, B&W merely argues that, because Liggett and R.J. Reynolds had used volume rebates in the economy segment, B&W's volume rebates could not have been a "signal" that B&W had no intention of expanding the segment. However, Liggett's and R.J. Reynolds' small volume rebates before B&W's entry does not change the fact that B&W's documents emphasized that rebates, unlike list-price reductions, would not be passed on to the consumer and therefore would not expand the economy segment.[25] *See* Pet. Br. at 10. Moreover, B&W's volume rebates dwarfed all previously existing rebates. *See id.* at 8 n.12.

g. *Higher Prices.* B&W denies neither that the discount between generic cigarettes and full revenue cigarettes fell from 40% in 1985 to 27% in 1989 nor that all prices rose. Thus, consumers paid more for both generic and branded cigarettes. The only exception resulted from Liggett's introduction of a so-called subgeneric cigarette, Pyramid, in December 1988 at the same list price that it had been selling generic cigarettes before B&W's entry. Although during trial four other manufacturers came to imitate Liggett's Pyramid, the subgenerics still accounted for only a small portion of generic volume. J.A. 290, 348. Moreover, by relying on subgenerics as evidence of competition, B&W effectively acknowledges that its 1984-85 below-cost, discriminatory rebates on black-and-whites deprived consumers from mid-1985 until the end of 1988 of the opportunity to purchase cigarettes at the deep discount that Liggett had provided before it was disciplined.

B&W minimizes its contemporaneous claim of credit for slowing the growth rate of the segment, saying that "the

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[25]That Liggett's expert claimed "no tacit collusion in the generic segment during the alleged period of predation" (Resp. Br. at 19) correctly indicated merely that B&W acted independently in disciplining Liggett. After all, the other firms did not then sell black-and-whites or participate in B&W's unprecedented rebates.

rate of growth necessarily slowed because of the larger base against which growth was measured." Resp. Br. at 27. But its claiming credit for that development shows, as the district court observed in denying a directed verdict, that B&W's "own executives . . . thought it was not only a possible or plausible scenario but that, in fact, what they said they were going to do and wanted to do succeeded or was succeeding." Tr. 67:64.

For the foregoing reasons and those stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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